DELIVERING THE GOODS: PUBLIC WORKS
FINANCING AND MANAGEMENT

Contractor Document

# State Finance for Local Public Works:

# Four Case Studies

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by Analytical Services
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## INTRODUCTION

Concern over the nation's public works is increasing. In a Congressionally-mandated study, the National Council on Public Works Improvement found that the share of public spending devoted to roads and transportation, water resources, and waste disposal is declining.[1] Infrastructure spending is also declining relative to private investment and Gross National Product. In 1960, federal, state and local governments spent $ 0.15 on public works investment for every dollar of private capital spending.[2] By 1985, this total had dropped to less than $ 0.07. Public infrastructure enhances the productivity of private capital in producing the nation's output of goods and services. Declines in infrastructure spending can thus reduce the effectiveness of private capital and increase the cost of production.

Spending trends are not necessarily a cause for concern in themselves. No one level of spending will ensure appropriate levels of public services and environmental protection. Improvements in technology and management can get more out of every dollar spent. However, the combination of these trends with increased traffic congestion, reduced air and water quality, and waste disposal problems has convinced many that we must spend more.

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1 National Council on Public Works Improvement, Fragile Foundations: A Report on the Nation's Public Works, Final Report to the President and Congress, February, 1988.

2 Author's calculations based on Fragile Foundations, Exhibit II-2, p. 47.

Concern over public works facilities has collided with budgetary constraints at all levels of government. The federal government has historically been the source of just under one-third of the nation's public works spending.[3] Federal budget problems, combined with a political philosophy favoring local discretion, have placed more of the infrastructure burden on state and local governments. State and local governments have historically financed most public works spending. The state share of infrastructure spending has declined even further than the federal share, however, making local governments responsible for nearly half the nation's public works spending in 1985.

State and local government budget constraints are unlikely to ease soon; rather, they are likely to become more severe. Since the enactment of Proposition 13 in California a decade ago, state and local government tax and spending limitations have grown dramatically. States have enacted 44 different types of limitations since 1978, compared with a total of 52 up to that time. Limitations have been enacted in 31 states since 1978, compared with 41 up to that time.[4]

The Tax Reform Act of 1986 increased the cost of infrastructure spending to state and local governments by restricting the availability of tax-exempt financing. Many

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[3] Fragile Foundations, p. 45.

[4] Author's compilations based on Advisory Commission on Intergovernmental Relations (ACIR), Significant Features of Fiscal Federalism 1988 Edition, Vol. II (Washington, D.C.: ACIR, July 1988), Table 90.

localities borrowed heavily in anticipation of the new restrictions, but will face serious cost shocks when these funds are exhausted. Governments will be pressured to postpone needed capital maintenance, renovation, and construction in favor of meeting acute needs like housing, public safety, and health care for the uninsured.

Despite these fiscal constraints, several trends suggest that infrastructure spending will continue to be largely a state and local responsibility. Continuing federal budget problems foreclose dramatic increases in intergovernmental aid. Many public works facilities are inherently local, providing benefits and services that accrue largely to the residents of the surrounding locality. Increasing reliance on user fees, which are local money, promotes state and local control and autonomy. State and local officials are able to judge local needs, financial resources, and economic conditions first-hand and devise solutions appropriate to local circumstances.

It is widely recognized, nevertheless, that the federal government must continue to participate in infrastructure provision. The quality and extent of water and sanitation facilities influence public health; adequate transportation facilities promote social, political, and economic growth and integration. As the Council pointed out in its final report,

> "Intergovernmental aid still is necessary to launch major projects of national interest, or to help governments with limited fiscal capacity."[5]

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5 Fragile Foundations, p. 12.

Revolving loan funds (RLFs) for public works offer one potential way to stretch available funds further and achieve the leverage of federal participation and the advantages of state and local policy control. The next section describes these funds and their use in state and local public works programs.

## REVOLVING LOAN FUNDS

Several state RLFs provide loans to local governments, generally for the construction of a wide variety of public works facilities. Loans may be provided at market interest rates or may be subsidized using other state funds. The legislature must generally appropriate funds -- from taxes or fees, bond issues, or federal aid -- for the fund's initial capital, and, in the case of debt finance, to provide a reserve against defaults.

An RLF can be self-sustaining because interest and principal payments by borrowers are returned to the fund to be reloaned to other borrowers. In an ordinary loan program, in contrast, loan payments are returned to the lending government's general revenues, foreclosing aid to new borrowers unless new funds are dedicated.

### RLFs AROUND THE NATION

By 1986, 15 states in all regions had established programs to finance a wide variety of public works facilities and 19 more

were setting up programs.[6] Some funds were established in the 1980s in response to federal aid cuts; others have operated for 20 years and more. Under the Water Quality Act of 1987 (P.L. 100-4), federal construction grants for wastewater treatment facilities will be phased out and used to capitalize state RLFs.

This report studies three states' funds in detail: the New Jersey Infrastructure Bank proposal and the programs that were subsequently enacted; the Washington Public Works Trust Fund; and the Wyoming Joint Powers Act Loan program, one of the oldest such programs in the country. The report also examines the Massachusetts MassBank proposal, a different financing initiative that was not enacted, and the state's spending response.

The states selected differ widely in circumstances and political and economic composition. The programs likewise represent a variety of financing techniques, program design, and targeting criteria. Their similarities suggest the potential elements of a successful program; their differences suggest some of the adaptations that must be made to each state's individual circumstances.[7]

This report takes no positions about the desirability of RLFs for infrastructure finance. Rather, it uses the state experience to illustrate the practical aspects of this type of

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[6] Apogee Research, Inc., The Nation's Public Works: Report on Wastewater Treatment, National Council on Public Works Improvement, May, 1987, p. 112.

[7] These issues will be explored in the second report prepared under this contract.

program and the implications of the state experience for the federal role in infrastructure provision.

## ADVANTAGES OF RLFS

RLFs can have certain advantages over bonds or pay-as-you-go financing for public works construction.

Stable funding. Since the deterioration of public works facilities and services is gradual, localities often postpone public works improvements in favor of pressing current needs. Because RLFs are self-sustaining, they are insulated from other budget priorities.

Financing flexibility. RLF loans can offer more financing flexibility than bonds. Bond financing depends on and affects a state's credit rating; an RLF, once it has been capitalized, does not. RLF loans can be issued at terms and interest rates that reflect local circumstances, and can be targeted to help rebuild distressed areas. In contrast, bond terms must reflect capital market conditions, and the issuing jurisdiction or authority must demonstrate the financial capacity to repay the debt.

Improved pricing of public works services. Many public works facilities produce revenues from user fees. A locality's need to repay loans can encourage it to set user fees that more accurately reflect the costs of serving particular users.

Improved capital planning. Federal public works grants are sometimes criticized for promoting capital construction even when

it does not serve local needs.[8] Aid provided through an RLF is less biased toward new construction, since the locality must commit its own funds to repaying the loan. This promotes the construction of needed facilities at an appropriate scale of operation.

## DISADVANTAGES OF RLFS

RLFs can also have certain drawbacks.

Affordability for distressed areas. While some RLFs target a share of aid to distressed communities, some such areas may not be able to manage even subsidized loans at favorable terms. To accommodate such localities, states generally supplement RLFs with other aid to ensure that all localities can finance adequate facilities.

Increased interest costs. While RLFs are an innovative approach to capital finance, neither bonds sold to private investors nor intergovernmental loan programs are "new" money. All government spending is ultimately financed by taxes or other charges.

Debt finance largely affects the timing of government spending. It allows the costs of long-lived projects to be paid over a larger segment of their useful life, makes some projects feasible sooner than they might be on a pay-as-you-go basis, and can allow the issuing government access to sources of capital outside its borders. However, borrowing increases the costs of

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8 Fragile Foundations, p. 92.

capital projects by the amount of interest and other related costs that must be paid.

Weakened budgetary control. When a government program provides subsidized loans, its budgetary discipline may be weakened. The federal government and many states do not explicitly appropriate or account for the subsidy inherent in reduced-rate loans.[9] When a government borrows at a higher interest rate than it lends, government spending goes up by the difference. Failing to account for this subsidy makes both the subsidized program and its financing method appear cheaper than they are.

Increased user fees. When a grant program is replaced with a loan, localities must generally demonstrate credit-worthiness. Many localities must increase public works user fees to make the project economically viable. The impact of such fees on lower-income groups and distressed and hard-to-serve areas often causes concern.

Earmarking repayments. To provide a continuing source of funds, loan repayments must be earmarked for the fund rather than deposited in the state's general revenues. Otherwise, the program's funds will be depleted with the first round of loans. However, segmenting funds in this way can weaken legislative and

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[9] For a discussion of this and related issues in accounting for federal loan programs, see Executive Office of the President, Budget of the United States Government Fiscal Year 1989, Special Analysis F, Section VII.

executive control over budget priorities.[10]

## THE NEW JERSEY INFRASTRUCTURE BANK

New Jersey is the nation's only all-urban state as defined by the U.S. Bureau of the Census.[11] New Jersey is an affluent state, but is not without its economic problems. The state's average per capita income of $20,342 in 1987 placed it nearly one-third above the national average.

It is the nation's most densely-populated state, with over 1,020 residents per square mile, compared with a national average of just over 68. High population density can increase the cost of providing public works services and increase the pressures on existing public works facilities. New Jersey also has a higher proportion of housing built before 1940 -- 33 percent -- than the national average of just over 26 percent. The average age of housing reflects a community's age, and thus can serve as a proxy for the age and condition of its infrastructure.[12]

Perhaps due to its greater density, the state's population

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10 For a detailed discussion of the budget policy effects of earmarking, see Charles F. Adams, Astrid E. Merget, and Frederick D. Stocker, "Earmarking Revenues for Public Works Projects," A Report to the National Council on Public Works Improvement, July, 1987.

11 Background data on the states are based on U.S. Bureau of the Census, Statistical Abstract of the United States 1988, Tables 33, 682 (updated by the author), and 1222.

12 For a discussion of housing age as a proxy for infrastructure condition and other community characteristics, see Sophie M. Korczyk, Community Development Block Grants: Reauthorization Issues (Washington, D.C.: Congressional Budget Office, 1980), p. 13-14.

has grown more slowly than the rest of the nation. During the 1970s, New Jersey's population increased by 2.7 percent, compared with 11.4 percent nationally. Between 1980 and 1986, the growth rate rose to 3.5 percent, but this was still well below the 6.4 percent growth recorded nationally.

New Jersey has significant public works problems. In addition to the road congestion endemic to most densely populated areas, more than 120 communities are under sewer bans and the state faces serious solid waste disposal problems. According to state officials, New Jersey currently sends 60 percent of its solid waste out of state, but has set the goal that each county will be self-sufficient in waste disposal by 1992. State officials indicate the state does not want to have "orphan garbage."[13] Each county must maintain a ten-year solid waste management plan that is updated every 2 years. If a county does not comply, the state can implement a county plan at the county's expense.

With slower growth, New Jersey was less able than many states to tap into new population growth for its emerging public works needs. State legislative staff describe the legislature as activist, and the state has a number of environmental programs.

The New Jersey Infrastructure Bank was first proposed by Gov. Thomas H. Kean in 1982 as a multi-faceted approach to

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[13] Conversation with Michael Walker and Ronald Dotsey of the New Jersey State Department of Environmental Protection, Bureau of Solid Waste and Resource Recovery Finance, Trenton, December 5, 1988.

meeting the state's infrastructure needs and compensating for cutbacks in federal aid.[14] The Bank would have separate program components aiding wastewater treatment, water supply, solid waste disposal, and transportation projects. The Bank was projected to generate an average of $2.42 in capital investment for every $1.00 of state and federal funds loaned.[15]

Neither the Governor's proposal nor a subsequent legislative substitute bill were adopted in their original form. Nevertheless, separate programs aiding all but water supply were enacted in 1984 and 1985 and have provided more in aid than the Bank originally contemplated. The evolution of New Jersey's infrastructure programs illustrates the role of financing techniques and balance of executive and legislative branch power in determining a program's structure.

## THE PROPOSAL

The Bank's major operational characteristics were its financing, organization, and project selection and targeting criteria.

### Financing

The Bank was to have three major financing tools: equity

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14 Memorandum from W. Cary Edwards, Chief Counsel, Governor's Office, to New Jersey State Senate, New Jersey General Assembly, September 28, 1982.

15 Weighted average of the projections for the separate program components calculated by the author based on data in Office of the Governor, New Jersey Infrastructure Bank: Technical Papers, May, 1983, Appendices I - III.

loans, a bond bank, and revenue bonds.

**Equity Loans**

The Bank was to be capitalized with over $900 million in equity capital over a six-year period, from which it would make loans to localities for wastewater treatment, water supply, and solid waste disposal projects. These project categories were to be served by separate lending "windows;" the Bank was to have no jurisdiction to commingle funds.

The Bank's wastewater treatment component of these loans was to be the largest, totaling $792 million over a six-year period. Loans for water supply and solid waste disposal projects would be capitalized with the proceeds of $115 million in general obligation bonds over three years.

The equity loans would be capitalized largely with funds already available to the state: federal wastewater treatment grants under the Clean Water Act totaling $100 million annually for six years; and $155 million in state general obligation bonds that had been authorized but not yet issued. The only new funds would be $152 million raised by the state as a match for federal wastewater treatment grants. This total would have been the cost of the state's 8 percent match if all 237 wastewater treatment projects then on the state Department of Environmental Protection priority list received federal funding.

The plan required federal permission for the state to convert federal Clean Water Act grants to loans. This conversion was ultimately required by federal law starting in 1989. The

Bank's structure also required that New Jersey voters pass a referendum allowing borrowers to repay Bank loans to the Bank rather than to the general fund.

The equity loans were the Bank's most important and controversial feature. The loans were designed to stretch, or leverage, available federal and funds to cover a larger share of the state's construction needs. This leveraging would occur in two ways. First, the loans, usually at zero interest, would replace the prior grant program. Localities with small projects or without access to credit markets would receive 100 percent loans at interest rates designed to result in equivalent debt service to the 63 percent zero interest loans. While available grants might not be sufficient to fund all eligible projects, loan repayments and interest would be recycled so that every locality would eventually be served. This "revolving" feature of the program increased the value of projects that could be financed by 53 percent over that attainable with grants alone.[16]

The second major leveraging effect would result from the increased local contribution to project costs. Loans would cover only 63 percent of project costs; the participating localities would have to pay the remainder. Prior to fiscal year 1985, federal grants covered 75 percent of eligible project costs, but this was reduced to 55 percent under the 1981 amendments to the Clean Water Act. Localities would finance their increased share

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16 Author's calculation based on Technical Papers, Exhibit I-A.

of project costs as well as loan repayments with user fees, which could have to increase by up to 30 percent.[17]

Several controls were designed to ensure the security and repayment of these loans:

- The borrower locality would pledge to set user fees or taxes high enough to meet all operating costs and debt service.
- The locality would pay principal and interest payments into a debt service fund held by a trustee bank and would maintain a debt service reserve fund with the trustee bank equal to one year's principal and interest.
- The locality would sign a deficiency agreement promising to replenish its reserve fund with local taxes should it draw on the fund.
- If the locality did not meet the terms of the deficiency agreement, the Bank could intercept certain state aid to the locality to meet the locality's obligations.

These provisions were important to the Bank's design. Without effective repayment provisions, its loans would become grants, and the revolving feature would be lost.

Bond Bank

The Bank's framers envisioned that localities could use the equity loans in conjunction with a bond bank, also established under the Bank. A bond bank assists localities by acting as an intermediary between local governments and credit markets.[18] The

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17 Technical Papers, p. 8.

18 Bond banks and their use in various states are discussed in Institute of Public Administration, "The Role of Special Districts and Public Authorities in Public Works Finance," A Report to the National Council on Public Works Improvement, August, 1987, pp. 112 ff.

bond bank groups small local bond issues into a single larger issue. Localities benefit because the bond bank, as a state agency, can often obtain a lower interest rate than individual localities, and because local governments save administrative expenses.

The bond bank was to be available to localities for the local share of Bank-financed projects. For localities using both equity loans and the bond bank, the equity loans would be subordinated to the bond bank bonds.

**Revenue Bonds**

New Jersey authorities and agencies may issue bonds backed by state guarantees, revenues, or the moral obligation of the state. The Bank's framers did not envision using an RLF to finance transportation projects, since funding for the Federal Highway Trust Fund was assured for the long term.[19] Instead, the Bank would issue revenue bonds, backed by part of the gasoline tax and other transportation revenues. The Bank would make available up to $200 million annually in state matching funds for federal highway grants and in funding for state and local roads.

**Organization**

The Bank was to be a lending authority located in the executive branch. It was to be governed by eleven directors: the State Treasurer (also chairman); the Commissioners of the Departments of Environmental Protection, Transportation, and Community Affairs; four members appointed by the State

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19 Technical Papers, p. 10.

legislature; and three members appointed by the Governor. As an executive agency, the Bank's decisions were to be subject to the Governor's veto power.

The organizational structure and powers of the Bank created concern from the outset. A state government document describing the Bank characterized it as "...solely a financing vehicle[.]"[20] However, some observers felt that the Bank directors' power to decide which localities got loans and on what terms made it a policy organization as well.[21] The Bank's directors were to establish credit policy and negotiate the terms of each transaction with the applicant localities, giving them considerable discretion over state economic development policies.

The extent of this discretion caused concern among some observers. Testifying before the New Jersey Senate Energy and Environment Committee, Harvard University Prof. Herman B. Leonard argued that the proposal posed "...deep questions about the division of authority between the legislative and executive branches," and that the Bank's power to raise and dispense funds assigned legislative functions to the executive branch.[22]

Leonard may have overstated the depth of the constitutional conflict inherent in the Bank's proposed structure. Legislatures

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20 Technical Papers, p. 4.

21 Richard J. T. Moore and Nancy G. Beer, Lessons of New Jersey's Proposed Infrastructure Bank (Princeton, NJ: Princeton University, 1984), p. 30.

22 Statement of Herman B. Leonard before the Senate Energy and Environment Committee, New Jersey Senate, September 4, 1985, pp. 17-18.

generally delegate a large share of program discretion to executive agencies. In the end, however, the legislature proved unwilling to delegate as much discretion as the proposal contemplated.

## THE DEBATE

The fate of the Bank was strongly influenced by its proposed size, discretion over the targeting of aid, and the source and likely continuity of funds to capitalize the program.

### The Volume and Targeting of Bank Assistance

The Bank was projected to control a large share of the state's capital spending. At the time the Bank was proposed, the state had about $2.3 billion outstanding in general obligation debt and another $8.7 billion in outstanding agency and authority debt that was backed by revenues, state lease agreements, and the moral obligation of the state.[23] By comparison, the wastewater treatment plant component of the Bank, its largest revolving loan segment, was expected to generate $1.9 billion in debt-financed construction.[24] The state's debt service on general obligation bonds alone was $272.5 million in 1984; annual loan repayments in the wastewater treatment program were projected to rise from $7.9 million in its second year of operation to a peak of $80.6

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[23] Moore and Beer, pp. 10-11. Not all the state's outstanding debt was incurred to finance public works projects. Like many states, New Jersey was using debt to finance programs like mortgage assistance for owner-occupied housing.

[24] Technical Papers, p. I-5.

million once the revolving component was fully operational.

The Bank was thus projected to control a large and growing portion of state capital spending that was insulated from other government spending priorities by the revolving loan feature. The original proposal did not specify how would the Bank would allocate this capital. The Bank could equally have subsidized an aging and fiscally troubled cities as thriving communities struggling to accommodate growth.

**The Source and Continuity of Funds**

The lack of targeting guidelines appears to have been particularly problematic in view of the Bank's projected funding sources. More than two-thirds of the Bank's capital was to come from federal wastewater treatment grants that the state would convert to loans. The grants had identifiable beneficiaries, while the projected loans did not. Politically powerful communities such as Camden, a county of nearly 76,000, were able to protect their interests, at least initially, and block the conversion of grants to loans.

Converting the grants to loans also caused concern over the increased user fees needed to meet operating costs and debt service and accumulate required reserves. User fees are becoming increasingly important in financing facilities that benefit identifiable users. Fees that reflect the cost of service can allocate costs fairly among different users, indicate the appropriate scale of capital facilities, and promote more efficient utilization of facilities through such activities as

water conservation, recycling, and changes in traffic patterns.

The Bank's proposed reliance on use fees raised several concerns. One was that increased local financing would hasten the end of state and federal grants.[25] Another fear concerned the perceived shift of financing responsibility from "government" to "the people" through increased user fees.[26] Tax finance generally bases payments on ability to pay, allowing for redistributing income among areas or individuals. User fees, in contrast, are based largely on consumption and are thus frequently seen as regressive.

## THE PROGRAMS ENACTED

Three public works programs were ultimately enacted. The New Jersey Transportation Trust Fund Authority Act of 1984 (P.L. 1984, c. 73) authorized $142.5 million in spending on transportation system improvements financed by revenue bonds and dedicated motor vehicle fuel taxes. This total was increased to $320.3 million in 1988. The Transportation Trust Fund undertakes direct spending programs and finances state aid to counties and municipalities for transportation system improvements.

The New Jersey Wastewater Treatment Trust Act of 1985 (P.L. 1985, c.334) created an independent financing authority with the power to issue bonds backed by the Trust's loan agreements with

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25 Moore and Beer, p. 36.

26 Assembly Majority Leader John Paul Doyle, letter to the editor, The New York Times, quoted in Moore and Beer, p. 36.

participating municipalities. These agreements, in turn, are secured by user fee covenants, a state-appropriated reserve fund, and municipal bond insurance.

The Resource Recovery and Solid Waste Disposal Facility Bond Act of 1985 authorizes low or no interest loans, limited to 10 percent of total project costs, for the development of resource recovery and environmentally sound sanitary landfills. A bill authorizing an additional $135 million in general obligation bonds for this program is pending in the legislature.

The wastewater treatment and resource recovery programs provide significantly more aid than originally planned for these components of the Bank (Table 1). For example, the wastewater treatment program was projected to receive $396 million in capital in its first three years of operation; it will receive $490.8 in its first two years. The solid waste disposal program has received $168 million in four years, compared with a projected $50 million in three years.

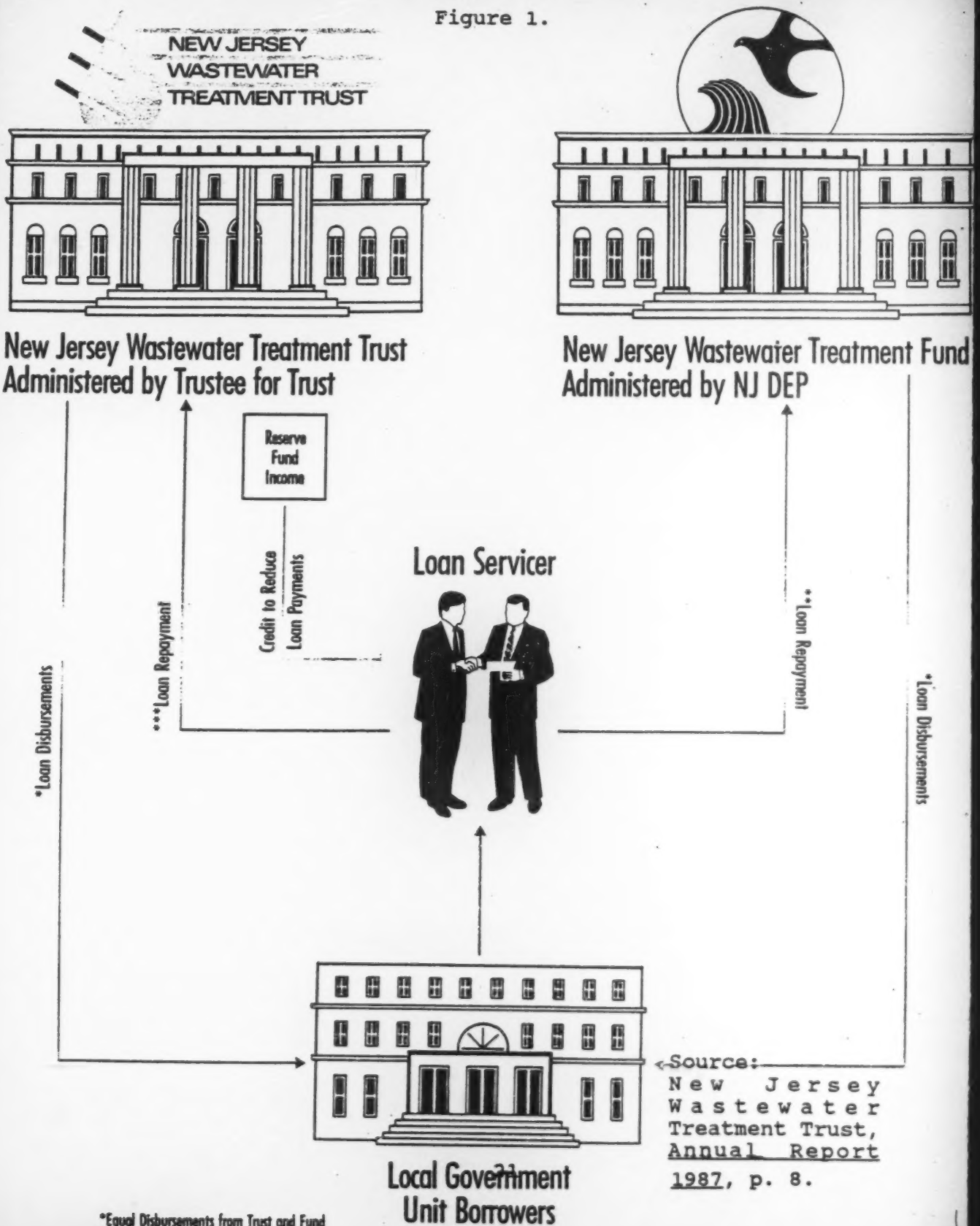
**The Wastewater Treatment Program**

The New Jersey Wastewater Treatment Financing Program consists of the New Jersey Wastewater Treatment Trust (the Trust) and the New Jersey Wastewater Treatment Fund (the Fund), administered by the state Department of Environmental Protection (Figure 1). In its first year, the program provided funding for 7 wastewater treatment facilities; it expects to fund 13 projects in the second year. The program was able to fund all eligible applicants in its first year, but is not expected to be able to

WASTEWATER TREATMENT FINANCING PROGRA

# FLOW OF FUNDS

Figure 1.




Source: New Jersey Wastewater Treatment Trust, Annual Report 1987, p. 8.

Table 1.

New Jersey Infrastructure Loans: Proposed and Enacted
(in millions of dollars)

| Year | Wastewater Treatment | Solid Waste Disposal |
|---|---|---|
| | **New Jersey Infrastructure Bank** | |
| Bonds or other capital | | |
| 1 | $132.0 | $15.0 |
| 2 | 132.0 | 25.0 |
| 3 | 132.0 | 10.0 |
| Loans | | |
| 1 | $118.8 | $ 4.8 |
| 2 | 139.0 | 9.6 |
| 3 | 149.6 | 14.4 |
| | **Programs Enacted** | |
| Bonds or other capital | | |
| 1985 | -- | $119.0 c/ |
| 1986 | -- | -- |
| 1987 a/ | $320.8 | -- |
| 1988 b/ | 170.0 | -- |
| Loans | | |
| 1987 | 248.0 | 48.0 |
| 1988 | 141.6 | -- |

Sources: Technical Papers, Appendices I, II, and III, and New Jersey Wastewater Treatment Financing Program Financial Plan, May 15, 1987 and May, 1988.

a/ Includes $130.8 million in revenue bond proceeds and $190 million in state appropriations.

b/ Includes $80 million in Trust revenue bond proceeds, $75 million in USEPA grants, and $15 million in state appropriations (the required 20 percent state match for EPA grants) which will be used to establish a reserve fund to secure the Trust's revenue bonds.

c/ An additional $49.5 million in borrowing authority was transferred to this program in 1985.

do so in its second year.

**Financing**

Funding for eligible projects comes from three sources:

- A market-rate loan from the Trust for half the allowable cost of the projects. These loans are financed by the proceeds of revenue bonds issued by the Trust.
- A loan at zero interest from the Fund for the other half of allowable project costs.
- The participant locality finances unallowable project costs as well as any allowable costs that may exceed the Trust and Fund loans.

The Financing Program thus reduces localities' interest costs by 50 percent. The Trust estimates that the combination of lower interest costs and economies of scale reduces participants' overall financing costs by 30 percent.[27] To reduce the burden of loan repayments further, localities may capitalize interest during the project's construction period. The Trust and the Fund are generally parity creditors of the locality.

The Fund's component of the first round of loans was financed by state general fund appropriations. For the second round of loans, the Fund component will be financed using $71 million of the state's nearly $95 million in federal wastewater treatment construction grants. This total represents the maximum allowable 75 percent of the state's allocation for federal fiscal year 1988. The federal program requires that states provide a 20 percent match to the federal grant. This total, approximately

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27 New Jersey Wastewater Treatment Financing Program, Financial Plan Submitted to the State Legislature by The New Jersey Wastewater Treatment Trust, May 1988, p. 1.

$15 million, will be used to establish a reserve fund for the revenue bonds to be issued by the Trust.

**Applying For Aid**

The Trust offers seminars for localities to acquaint them with the advantages and the requirements of the program. Localities must meet three deadlines to be eligible for funding: planning (November 30), design (March 1), and application (April 1).

Application requirements are extensive. The state requires that participant localities hire a bond counsel, since the locality issues bonds to the Trust and the Fund. The locality must also submit a financial addendum showing the project's financial viability, user fee covenants (as described above) and financial disclcsure information needed to comply with U.S. Securities Exchange Commission requirements.

Attrition between deadlines is high. For the fiscal year 1989 planning cycle, 64 projects, totalling $900 million, were suggested by localities. Of these projects, 43, for a total of over $400 million, met the first planning deadline, and 23 were expected to complete the full planning cycle. Localities unable to complete their applications on deadline, or whose costs increase between the time of application and award, move to the head of the following year's priority list.

**The Resource Recovery and Solid Waste Disposal Program**

This program is operated by the Division of Solid Waste Management in the state Department of Environmental Protection.

The Natural Resource Bond Act of 1980 authorized $50 million in general obligation bonds to finance resource recovery and other environmental management programs. Of this total, $49.5 million was transferred to be awarded to localities under the terms of the 1985 legislation. With an additional $119 million in general obligation bond proceeds authorized in 1985, the state now has $168 million available for loans to localities.

Current terms provide for loans at zero interest for 27 years, with payments to commence one year after the plant begins operation. Localities are required to sign rate covenants securing their obligations to the state. Loans issued under this program are junior to the locality's other securities.

State regulations provide rules for the award of funding. However, the legislature has, in effect, taken over the project selection process. Bills appropriating funds for 14 plants are currently pending in the legislature. Program officials indicate that one project, for Essex county, has received a loan of $48 million.

## BALANCED POWERS: THE LEGISLATURE'S ROLE

The lack of legislative oversight and definite targeting criteria in the original Bank proposal are generally believed to be at least partially responsible for its failure to be enacted as proposed.[28] The legislature now gets two opportunities to

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[28] This point is made by Moore and Beer and was also made in discussions with New Jersey Senate staff members Mark Connelly and Algis Matioska.

review the wastewater treatment program annually. Project priorities are developed by the Trust according to the federal priority ranking system and referred to the legislature by January 15 of each year for action to authorize funding. The Trust must also submit a financial plan to the legislature by May 15 of each year. The Senate and Assembly must both approve the plan within a prescribed statutory period or the financial plan is deemed disapproved and the Trust cannot proceed with its financing program.

Plans are being formulated to expand the Trust's financing activities and jurisdiction. The state's water supply program may be incorporated into the Trust, and its $600 million limit on outstanding revenue bonds may be raised.[29] These plans suggest some degree of satisfaction with the Trust's operation and ability to meet the state's needs.

At the same time, however, some concerns about the program remain. Senate staff are concerned about the distributional consequences of substituting user fees for tax finance, about the Trust's wide discretion as a semi-autonomous state authority (even though there is no reason to believe this discretion has been abused), and about the erosion of budgetary discipline that stems from the lack of explicit appropriation of interest subsidies on Fund loans.[30]

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[29] Conversation with Janice Brogle, New Jersey Wastewater Treatment Trust staff, Trenton, NJ, December 5, 1988.

[30] Conversation with Mark Connelly and Algis Matioska, New Jersey Senate staff, December 5, 1988.

## MEASURES OF PROGRAM PERFORMANCE

The wastewater treatment and resource recovery loan programs are too new to permit broad conclusions about their effects. Only one wastewater treatment project has been completed, and the resource recovery program has only distributed one loan. Certain early indicators can, however, suggest the programs' effect on infrastructure provision.

### Wastewater Treatment

The wastewater program uses the federal priority list to rank wastewater projects in order of need. Projects receive points on the basis of water use and quality, project discharge priorities, and population served.

Actual funding does not exclusively reflect need, however. Of the 43 projects that completed the first application step, 17 ranked below 100 on the federal priority list, and of the 13 projects likely to receive funding for state fiscal year 1989, 6 are ranked 40 or lower. Many localities at the top of the list opted to receive federal grants out of the 25 percent of the federal allocation still available for grants. Application for loans is voluntary, and many localities do not want development or do not have the resources necessary to complete the application process. However, since little other funding for wastewater treatment plant construction and improvement is available, most localities are likely to seek aid from the program eventually.

**Resource Recovery**

The state's resource recovery loans cover only 10 percent of project costs, resulting in a high degree of leverage. Financial leverage refers to a program's multiplier effect, or its ability to attract other, hopefully additional, spending. Leverage is a two-edged concept. On the one hand, a high ratio of leveraged funds to program funds seems to suggest that the program's funds have made a significant impact. On the other hand, a high leverage ratio could also suggest that the project could have gone ahead without aid, since the program funds were only a small part of the financial package.

Program officials feel that many larger projects in the state's northern counties would probably go ahead without aid. Many of these counties must construct resource recovery plants to comply with their solid waste management plans, since landfill space is in short supply. In smaller projects, on the other hand, the state aid could provide the additional funding that permits a project to go forward.

## THE WASHINGTON PUBLIC WORKS TRUST FUND

Washington has a mixed economy and a largely urban population, with four out of five residents living in urban areas. The state's population grew by more than one-fifth during the 1970s, but this growth slowed to 8.0 percent between 1980 and 1986. Washington is slightly less densely populated than the national average, with 67.1 persons per square mile, compared

with 68.1 persons nationwide. Its 1987 per capita income of $15,599 was roughly at the national average, but grew 45.4 percent during the 1980s, compared with a national average of 56.1 percent.

Washington is a young state, preparing for its centennial in 1989. Individuals interviewed for this report described the state's political atmosphere as activist and populist, and cited the state's reputation as a trend-setter.[31]

The Washington Public Works Trust Fund was developed in a process that began with a state survey of public works needs prepared as part of a report by the Congressional Joint Economic Committee.[32] Based on extrapolations of state data, The Washington State Infrastructure Study (hereafter The Study) had concluded that:

- relative to personal income and on a per capita basis, real capital spending for public facilities in Washington State was lower in 1983 than at any time in the past 20 years;
- meeting perceived capital needs projected to the year 2000 would require spending at levels more than two and one-half times the annual rates of the previous decade; and
- real capital outlays were projected to decline between 1983 and 2000.

Local governments' ability to meet their public works needs was

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31 John Naisbitt argues that most of the social invention in America occurs in five states, one of which is Washington. See John Naisbitt, Megatrends: Ten New Directions Transforming Our Lives (New York: Warner Books, Inc., 1982), pp. 6-7.

32 Philip Bourque and Nancy Rutledge, The Washington State Infrastructure Study (Olympia, Washington: Washington State Planning and Community Affairs Agency, 1983).

believed to be hampered by a "levy lid," enacted in 1971, limiting taxing districts to 106 percent of their highest levy of the past three years. Overriding the lid requires voter approval.

Unlike the Massachusetts and New Jersey proposals, which were introduced by the executive branch and then reshaped in the course of public debate, the Fund was a legislative initiative developed in a three-year incremental process involving both the legislature and the executive branch. In May, 1983, Gov. John Spellman signed into law Substitute Senate Bill (SSB) No. 3035, directing the Planning and Community Affairs Agency (PCAA; later the Department of Community Development) to prepare a comprehensive plan for the replacement and repair of state and local public works, including streets and roads, bridges, water systems, sewer and storm sewer systems, dams, and parks and recreation facilities.

To comply with the mandate of SSB 3035, the PCAA generated new data on state and local public works. It surveyed 700 local jurisdictions in the state on their anticipated needs and resources available to meet them, achieving an 87 percent survey response rate.

Based on this survey, The Washington State Public Works Report (hereafter The Report) found that local jurisdictions anticipated nearly $4.3 billion in public works needs over the next five years, but expected to be able to fund only 53 percent

of this total from available sources.[33] The largest needs and funding gaps were for street and road projects (44 percent of total project costs and 46 percent of the projected shortfall). Sanitary and storm sewer projects accounted for 26 percent of total needs.[34]

Early in 1984, the Legislature passed and the Governor signed into law Engrossed Substitute Senate Bill (ESSB) No. 4404, establishing a new program in the public works assistance account to make public works loans to local governments and special purpose districts. ESSB 4404 provided that the account would be capitalized by the proceeds of a state general obligation bond issue, supported by projected biennial appropriations of $10 million.

The statute also directed PCAA to report to the legislature on the financing, management, and standards to be used in determining the allocation and distribution of the loans provided. This report, entitled Financing Public Works: Strategies for Increasing Public Investment, laid the groundwork for the Washington Public Works Trust Fund as it was ultimately established.[35]

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33 State of Washington, Planning and Community Affairs Agency, The Washington State Public Works Report, December 1983, p. 24 and ff.

34 The Washington State Public Works Report, pp. 24 and 26.

35 State of Washington, Department of Community Development, Financing Public Works: Strategies for Increasing Local Investment, December, 1984.

The Fund's major features -- financial structure, organization, and project selection and targeting criteria-- emerged in subsequent research and legislation.

## FINANCIAL STRUCTURE

The Fund's capitalization and loan structure evolved over the course of the legislative debate.

### Capitalization

The Report offered 13 recommendations for increasing the state's capacity to finance its projected public works needs. These recommendations fell into three categories:

- o expanding local taxing and borrowing capacity;
- o enhancing local ability to market debt at competitive rates; and
- o augmenting state and local capital planning and evaluation capacity.[36]

The Board explicitly did not endorse the formation of a revolving loan fund for public works, citing "...uncertainty about appropriate methods of capitalization and distribution as well as local willingness and capacity to repay such loans."[37]

Financing Public Works proposed a fundamentally different financing approach. The Board recommended that the Fund be financed on a pay-as-you-go basis, eliminating the interest and issuance costs of bonds and reducing pressure on the state's debt capacity. The Board suggested that the legislature dedicate one

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36 The Report, pp. 11-23.

37 The Report, p. 17.

or more revenue sources to the Fund and increase the financial commitment provided in the legislation.

The report argued that pay-as-you-go finance channeled more of the available funds into local aid than was possible under debt finance. The appropriations envisioned in the statute could have supported a 25-year bond issue of $45 million to $47 million at then-prevailing interest rates. Deposited in an RLF, these funds could generate an estimated $315.2 million in local loans over a 25-year period.[38] In contrast, if the projected $10 million appropriation were loaned directly, it would generate $433.6 million in local loans over the same period.

Pay-as-you-go financing permits less lending in the program's earlier years. Projects that are deferred will ultimately cost more due to inflation, offsetting some of the expected savings. Even after allowing for inflation, however, the pay-as-you-go approach was projected to support nearly 13 percent more lending over the long term.

General obligation debt finance was further discouraged by both cost and availability considerations. The state had recently experienced the bond default of the Washington Public Power Supply System nuclear energy authority, which increased its borrowing costs. The state was also reaching to its statutory general obligation debt ceiling, which prompted debates over the appropriate use of the state's remaining debt capacity.[39]

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38 Financing Public Works, p. 7.

39 Financing Public Works, p. 6.

The Advisory Board also considered establishing the program as a bond bank. This approach was rejected because Washington localities were considered to be able to borrow on terms at least as good as those available to the state.[40]

The Fund was capitalized with dedicated revenues from utility and sales tax surcharges on local water, sewer, and garbage collection, and a portion of the real estate conveyance tax. In 1986, its first year, the Fund disbursed $17.1 million in loans (Table 2). This total was more than three times the annual appropriation originally contemplated in ESSB 4404. For the 1989 funding cycle, the Board is recommending $36.2 million in loans for the Legislature's approval. The increase in funds available is due to increases in the taxes on which the Fund's surcharges are based.[41]

**Loan Structure**

Localities must finance a minimum of 10 percent of project costs with local revenues, and can also add private funds and other resources. Interest rates during the 1989 loan cycle range from 0 to 3 percent, with loan terms not to exceed the lesser of 20 years or the useful life of the project. The Fund encourages localities to fund more than the minimum share by offering lower interest rates when local participation is higher.

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[40] Conversation with Hugh Spitzer, Chairman of the Public Works Project Advisory Board Subcommittee on Finance, Seattle, WA, November 28, 1988.

[41] Conversation with Pete Butkus, Fund Manager, Olympia, WA, November 29, 1988.

Fund loans are junior obligations of the locality and do not affect the locality's statutory debt ceiling.[42] While the program is too new to have experienced any defaults, Fund staff believe the localities want to meet their obligations, and local officials would face significant peer pressure against default or delinquency.

## ORGANIZATION

The Fund was developed and continues to operate under the direction of a large and broadly representative group of local elected officials, public works managers, and members of the public with public works expertise. The Report was prepared under the direction of a 21-member Public Works Advisory Board composed of state and local officials, academic researchers, and financial and engineering specialists. Financing Public Works was prepared under the direction of a 26-member Advisory Board that included most of the members who had overseen the preparation of The Report.

The Fund is directed by a 13-member appointed board that includes:

- o two elected officials and one public works manager from a list nominated by the association of Washington cities;
- o two elected officials and one public works manager from a list nominated by the Washington association of counties;

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42 Legislation putting the loans outside the locality's statutory debt ceiling was passed in the 1987 legislative session.

- three members from a list nominated by the Washington associations of water, public utility, and sewer districts; and

- four members of the general public, chosen to balance the Board's geographical composition and include members with professional expertise related to public works. The Governor appoints one of the general public members to chair the Board.[43]

This local participation reflects the state's policy, emphasized in the Fund's authorizing legislation, of encouraging local self-reliance.[44] Local self-reliance does not mean lack of state support, however. The state finances 67 percent of combined state and local own-source general expenditure, compared with a national average of 57 percent.[45]

## THE APPLICATION PROCESS AND PROJECT SELECTION

The application process and project selection criteria are designed to build local planning and financial capacity while meeting pressing needs.

### Applying for a Loan

All local government entities other than schools or port districts are eligible to receive Fund loans if they have a long-term plan for financing their public works needs. The plan must:

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43 Washington Laws, 1985, Chapter 43.155 RCW, Public Works Projects, Sec. 9.

44 Financing Public Works, p. 4 and Washington Laws, 1985, Chapter 43.155 RCW, Public Works Projects, Sec. 7.

45 Advisory Commission on Intergovernmental Relations (ACIR), Significant Features of Fiscal Federalism 1988 Edition, Volume II (Washington, D.C.: ACIR, 1988), Table 50.

- assess the capital needs for the specific system for which the loan application is being made;
- set priorities for major capital improvement projects planned to meet those needs over a five- or six-year period;
- estimate project costs and identify financing alternatives;
- have been updated at least once in the last five years;
- have provided opportunity for public input; and
- be formally adopted by the governing body of the local government.

Counties and cities must also be imposing the optional 1/4 percent real estate excise tax dedicated to capital purposes.

The application requirements are designed to establish planning standards and build local planning capacity rather than dictate or judge the quality of the locality's plan. In an interview, Fund staff emphasized that the application requirements are interpreted and enforced flexibly. For example, some small localities lacking public facilities or discussion forums have been encouraged to devise inventive ways to obtain public input. The town of Wilkerson, lacking a town hall for holding public meetings, obtained public input on its capital plan through discussions in local bars. In Albion, the mayor and his wife conducted a door-to-door survey of the residents. In Bellevue, on the other hand, local officials were able to consult with organized neighborhood groups. In 1988, Fund staff held eight workshops throughout the state to provide localities with technical support in filing their applications.

Projects eligible for funding include bridges, streets and

roads, water systems, storm sewers, and sanitary sewers. Loans are offered only for the repair, replacement, rehabilitation, reconstruction, or improvement of existing eligible systems to meet current standards and service needs. Projects with a new construction component may be approved if they are designed to meet existing needs. Localities whose applications are not funded in one application cycle do not receive preference in subsequent cycles.

Projects not designed to meet current needs are considered growth-related and not eligible for Fund financing. Existing needs were judged to be severe enough to warrant this limitation, but excluding growth projects from eligibility also served the purpose of leaving the program out of debates about where new development should occur. Financing Public Works suggested that new facilities to accommodate growth should be financed by the beneficiaries of such growth or by other existing state aid programs.[46] Washington localities have some authority to levy impact fees and exactions on new development to finance needed public facilities.

Localities may submit one application per eligible system in each loan cycle, for a maximum of five project proposals per cycle per jurisdiction (one for each of the five types of eligible systems). No one loan may exceed $1.5 million (up from $1 million originally), and jurisdictions receiving more than one loan may not receive more than $1.5 million in any one loan

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[46] Financing Public Works, p. 13.

cycle. The average loan for the 1989 cycle was $603,000, an increase of nearly 50 percent since the program's inception (Table 2).

To encourage long-term planning and avoid rewarding crisis management, the Fund offers only limited emergency assistance.[47] Beginning in April, 1989, the Fund will offer up to $1 million in loans (no more than $250,000 per request) to jurisdictions experiencing a failure of a critical eligible public works system. To enhance local planning capabilities, the Fund has begun to offer loans for basic local capital improvement planning to localities with financial need and limited technical capacity.

**Project Selection**

Project selection is governed by the principle that "...the more a community is already doing...for itself, the greater its eligibility for state Trust Fund support."[48] Applications are judged on both the locality's need for system improvement and its effort to meet its own needs. Need is measured by the severity of the problem, including such factors as flooding, contamination, and the potential loss of a system.[49]

Local effort is measured by system maintenance, financial management, and revenue acquisition. Evaluating the locality's

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47 Fund officials also believe the Fund is too small to accommodate the financing requirements of major system failures.

48 Financing Public Works, p. 12.

49 State of Washington, Department of Community Development, Public Works Trust Fund 1989 Loan Priorities, November, 1988, p. 5.

Table 2.

The Washington Public Works Trust Fund:
Funding and Uses, 1986-1989

| Program Use | 1986 | 1987 | 1988 | 1989 | Total |
|---|---|---|---|---|---|
| | | Percent of Funds Allocated | | | |
| Bridges | 1 | 9 | 3 | 3 | 4 |
| Storm Sewers | 4 | 16 | 2 | 2 | 5 |
| Roads and Streets | 28 | 14 | 38 | 29 | 29 |
| Water | 39 | 23 | 32 | 39 | 34 |
| Sewer | 18 | 38 | 26 | 27 | 27 |
| Combination | 11 | - | - | - | 2 |
| Capital Improvement Planning | - | - | - | a/ | a/ |
| Total Fund loans (in millions of dollars) | $17.1 | $17.5 | $28.8 | $36.2 | $99.5 |
| Average loan size (000) | $426.3 | $486.8 | $532.7 | $603.3 | na |

Source: Author's calculations based on State of Washington Public Works Board, Public Works Trust Fund Loan Priorities, various years.

a/ Less than one percent.

own management of its systems, including maintenance, discourages the deferral of local spending in anticipation of future state or federal aid, a major concern of the Fund's designers.

Requiring localities to tap their own revenue sources reduces the substitution of Fund loans for local funds, since localities are eligible for aid only if their own resources are inadequate. For water and sewer systems, the financial evaluation considers the locality's reliance on user fees, but systems are not required to be self-supporting. While legislators tend to see user fees as an indication of local effort, Fund staff believe that high user fees sometimes result from system neglect that leads to a high-cost facility. Thus, some localities may finance a significant share of water and sewer facilities through local taxes.

The legislation requires that the Board consider at least the following factors in setting project priorities:

- o local fiscal distress resulting from natural disaster or emergency public works needs;
- o the project's urgency and effect on citizens' health and safety;
- o project cost;
- o the number of communities involved; and
- o whether the project is located in an area of higher than average unemployment.[50]

The legislation also permits the Board to consider geographic

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50 Washington Laws, 1985, Chapter 43.155 RCW, Public Works Projects, Sec. 12.

balance across the state in its decisions. While no explicit geographic targeting criteria are used, the Board does attempt to spread available funds widely. As a result, the state's larger cities might generate a larger share of the program's income than they receive in loans.

The allocation of Fund loans among public works projects reflects the need patterns identified in The Report. In its first four years of operation, 32 percent of total funds have financed sanitary and storm sewers, and 29 percent have been used for roads and streets (Table 2). These projects represented the state's major unmet needs.

## BALANCED POWERS: THE LEGISLATURE'S ROLE

The legislature played a major role in the program's development and actively oversees its operation. Unlike the New Jersey Infrastructure Bank proposal, the Washington Fund proposal included proposed targeting criteria from the beginning, though the criteria were modified between ESSB 4404 and the final authorizing legislation.

The program was also structured to accommodate legislative oversight. Rather than awarding loans continuously over the course of the year, the Fund submits a priority list for the legislature's approval in November of each year. The legislature may delete projects from the list, but may not add projects. Legislators, Fund staff, and private-sector members of the Advisory Board feel that this feature maintains the integrity of

the program and avoids political "horse-trading" that could distort its effect on local development.

## MEASURES OF PROGRAM PERFORMANCE

The Fund's framers wanted it to make a difference in the state's unmet public works needs. Its success in meeting this goal can be measured by the share of funds devoted to distressed areas, leverage, and the state's reliance on the fund for public works aid.

### Funding for Distressed Areas

Loan programs are sometimes criticized as an aid device because needy areas may not have the ability to repay loans and thus may not apply for aid. Distressed areas receive a significant share of available funds. In the first four years of its operation, the Fund has allocated from 26.9 percent to 43.1 percent of its annual loans to areas meeting the program's definition of a distressed area (Table 3).

Distressed applicants are not much more likely to receive aid than the average applicant, however. The percentage of all applications funded has steadily risen from 15.2 percent in 1986 to 63.7 percent in 1989 as the Fund's criteria have become better defined and better understood by potential applicants (Table 3). Distressed areas have been only slightly more successful in their applications than the entire pool of applicants, with 23.2 percent of their applications funded in 1986 and 65.8 percent in 1989. Thus, while the program does devote a significant share of

Table 3.

Measures of Program Impact,
The Washington Public Works Trust Fund

| Measure | 1986 | 1987 | 1988 | 1989 |
|---|---|---|---|---|
| Financial | | | | |
| Leverage a/ | 2.34 | 2.28 | 2.59 | 2.02 |
| Value of projects (in millions of dollars) | $39.8 | $39.9 | $74.4 | $74.1 |
| Targeting | | | | |
| Percent of funds to distressed areas b/ | 38.6 | 43.1 | 33.7 | 26.9 |
| Percent of applications funded c/ | | | | |
| All areas | 15.2 | 32.1 | 62.9 | 63.7 |
| Distressed areas | 23.2 | 36.1 | 66.2 | 65.8 |

Source: Author's calculations based on State of Washington Public Works Board, Public Works Trust Fund Loan Priorities, various years.

a/ Ratio of total project funds to Trust Fund loan.

b/ Distress criteria are specified by statute; see text.

c/ Ratio of the value of loans approved to loans requested; local and other funds to be used for the project are not included in this calculation.

its funding to distressed areas, it does not favor distressed areas over other applicants.

**Leverage**

Leverage ratios in the Washington Fund have ranged from 2.02 to 2.59, implying that each dollar of fund loans attracted an additional $1.02 to $1.59 in other project financing (Table 3). With Fund loans accounting for up to half of total project costs, it is unlikely that most projects could have gone ahead at their planned scale in the absence of the program. The program's emphasis on local fiscal effort also suggests that program funds make the difference in aided projects, since localities are generally eligible for aid only if their own resources are insufficient to meet expected needs. Consequently, the program's financial performance seems to suggest a significant degree of leverage without the likelihood of extensive fiscal substitution.

**State Reliance**

In designing the program, the Advisory Board was concerned that it both be affordable for the state and have a discernible impact on the state's public works needs. The loans awarded in 1986 accounted for over 15 percent of that year's total state aid for public works.[51] Updated data on state public works aid were not available, but Fund staff members estimate that other sources of state aid for public works have remained largely unchanged in

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[51] Author's calculations based on The Council of State Governments, "State Assistance for Local Public Works," A Report to the National Council on Public Works Improvement, August 1987, Appendix C.

the intervening years, while Fund loans have more than doubled.[52] Based on this information, Fund loans now account for an estimated 30 percent of total state aid for local public works.

## THE WYOMING JOINT POWERS ACT LOANS

Wyoming is a young state, preparing to celebrate its centennial in 1990. In many ways, it retains a frontier mentality. Wyoming residents refer to the state as "a village with long streets;" and, according to a recent state slogan, "Wyoming is like America was." The state has experienced violent economic swings due to its reliance on minerals and energy production. The state's local aid and public works programs reflect both its small-town, populist attitude and its economic uncertainty.

Wyoming has 5.2 persons per square mile and is more than 70 percent rural by Census definitions. Between 1970 and 1980, the state's population grew by 41.3 percent, gaining an additional 8.0 percent between 1980 and 1986. Since 1979, however, the state both gained and lost an estimated 22,000 jobs.[53] Within the past two years, the state has also lost an estimated 25 percent of its assessed valuation and 10 percent of its

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52 Conversation with Pet Butkus, Bob Brandow, and Sharon Yamamoto, November 29, 1988.

53 Conversation with Richard Moore, engineering consultant and former Director of Wyoming Industrial Siting Administration, Cheyenne, WY, November 30, 1988.

population.[54] The state's budgetary policies have thus had to accommodate the demands of growth and precipitous decline.

The oil boom of the 1960s and the coal boom of the 1970s both required and made possible a rebuilding of the state's public works infrastructure. Boom towns that grew up around coal, oil, and uranium facilities needed schools, roads, and other public facilities quickly. The new development also brought income that helped the state meet these needs. Wyoming ranks second in the nation in severance tax collections, raising $764 per capita -- over 29 percent of combined state and local own-source revenues -- from this source in 1986.[55] Over the last decade, the state has substantially rebuilt its public-sector infrastructure.[56] A report to the National Council on Public Works Improvement found that Wyoming ranked first in the nation in per capita public works spending in 1986.[57]

Wyoming is a fiscally conservative state; in the last legislative session, a Democratic governor criticized a Republican legislature for overspending.[58] The state government

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54 Conversation with Richard Miller, Director, Wyoming Legislative Service Office, Cheyenne, WY, November 30, 1988.

55 Author's calculations based on ACIR, vol. II, pp. 115 and 119.

56 The Council of State Governments, Wyoming state appendix.

57 Council of State Governments data presented in Larry Ledebur, William Hamilton, and Roger Vaughan, "Changing State Roles in Public Works, "A Report to the National Council on Public Works Improvement, September 11, 1987, Table 7.

58 Conversation with Richard Miller.

accounts for 58 percent of state and local general expenditure from own revenue sources, just over the national average of 57 percent.[59] Counties may levy an optional one percent add-on to the sales tax to finance certain capital projects, but such levies expire when the project is finished. Localities can also impose impact fees and exactions on new industrial development to pay for needed facilities, but this financing tool is useful only when growth is occurring.

More than two-thirds of the state's total revenue is earmarked for highways, local government aid, water development, and schools.[60] A major feature of the state's fiscal structure is its reliance on "permanent funds," or trusts. There are two types of such funds: permanent land funds and permanent mineral trust funds.

Permanent land funds date from the state's admission into the Union. Upon admission, the state received certain federal land grants for support of its education system and various other social institutions, including the penitentiary, library, and certain medical and public health facilities. When such lands are sold, federal law requires that the sale proceeds be held in

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59 ACIR, Table 50.

60 Steven D. Gold, Brenda Erickson, and Michelle Kissell, Earmarking State Taxes (Denver, CO: National Conference of State Legislatures, 1987), p. 87.

trust and the trust income be used to support the institutions that were the beneficiaries of the grants.[61]

The state's permanent mineral trust funds are supported by mineral royalty and severance tax payments. The state may not breach the corpus of its permanent funds, but invests or loans out the funds for a number of different purposes, among them farm loans, water projects, and income-generating public infrastructure.

## FINANCIAL STRUCTURE

The Joint Powers Act (JPA) Loan program, administered by the Farm Loan Board, is authorized to provide up to $100 million in loans from the permanent mineral trust funds and other state permanent funds.[62] The program was established to help fiscally-pressed energy "boom towns" meet their public facility needs. The loans are provided for water and sewer facilities; social service facilities such as hospitals, recreation centers, and child care centers; and other public improvements.[63] Loans may

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61 State of Wyoming, 1987 Annual Report of the Department of Public Lands & Farm Loans, p. 2.

62 Wyoming Statutes Chapter 21, 1974, W.S. 16-1-102, et seq. The "Joint Powers" name stems from the fact that the law enables localities to cooperate in applying for a loan for a jointly-used facility. In practice, most applications are not made jointly.

63 Facilities designed for the following uses are eligible under the statute: water, sewerage, or solid waste; recreational facilities; police and fire protection agency; transportation; school and college; medical; courthouse, jail, and related uses; public health; electrical systems owned by municipalities prior to March 1, 1975.

be used for new construction as well as improvement of existing facilities.

In its 15 years of operation, the JPA program has awarded 266 loans totaling over $124.2 million (Table 4). Water and sewer facilities account for 54 percent of the program's loans. Another 34 percent has financed housing, medical facilities, education-related facilities such as college dormitories, energy related facilities, and miscellaneous "social infrastructure" projects such as senior citizen and child care centers and recreational facilities.

Program priorities have varied significantly over time. While water and sewer facilities are the single most important use of funds, the share of each year's loans devoted to these facilities has ranged from a low of 26 percent in 1982 to a high of 100 percent in 1978 (Table 4). Likewise, while streets, airports, and related facilities account for 10 percent of total program loans, this use has accounted for more than one-third of total program funds in some years.

Loans are secured by pledges of user fees generated by the facility being financed and are issued for a maximum term of 40 years. Interest rates charged are limited by statute to a range of 6 to 12 percent. Within this range, the rates charged vary according to market conditions.

Water and sewer user fees have traditionally not been adequate to support the facilities, because they have been

Table 4.

The Wyoming Joint Powers Act Loans:
Funding by Function, 1974 - 1988

| Year | Water/ Sewer | Transportation a/ | Solid Waste/ Wastewater b/ | Other c/ |
|---|---|---|---|---|
| | | Percent of Funds Allocated | | |
| 1974 | 36 | 0 | 0 | 64 |
| 1975 | 57 | 17 | 4 | 22 |
| 1976 | 85 | 0 | 0 | 15 |
| 1977 | 66 | 34 | 0 | 0 |
| 1978 | 100 | 0 | 0 | 0 |
| 1979 | 51 | 0 | 13 | 36 |
| 1980 | 64 | 4 | 3 | 29 |
| 1981 | 53 | 23 | 1 | 23 |
| 1982 | 26 | 3 | 1 | 70 |
| 1983 | 39 | 35 | 7 | 19 |
| 1984 | 56 | 1 | 2 | 41 |
| 1985 | 69 | 12 | 6 | 13 |
| 1986 | 78 | 11 | 0 | 11 |
| 1987 | 37 | 0 | 0 | 63 |
| 1988 d/ | 41 | 1 | 0 | 59 |
| Total | 54 | 10 | 2 | 34 |
| | | Total Lending (in millions of dollars) | | |
| $124.2 | $67.0 | $12.3 | $2.2 | $42.6 |

Source: Author's compilation of data in Wyoming Department of Public Lands and Farm Loans, "Joint Powers Act Report, As of October 31, 1988," unpublished.

a/ Streets, airports, and other transportation facilities.

b/ Categories combined for convenience of exposition.

c/ Housing, medical, and education facilities, energy-related facilities, and miscellaneous projects.

d/ Through October 31, 1988.

subsidized by other funding.[64] If user fees adequate to secure an applicant locality's loan would require precipitous increases, other aid may be provided to enable the project to go forward and ease a locality's transition to higher costs.

About 6 loans were considered troubled at the end of 1988.[65] Program officials indicate that loans would be rescheduled, if needed, for localities unable to meet their commitments.

## ORGANIZATION

JPA loan applications are considered monthly by the Farm Loan Board, rather than annually by the legislature as in the Washington and New Jersey programs. The Board consists of five elected officials, including the Governor, the state Treasurer, and the state Auditor.

## THE APPLICATION PROCESS AND PROJECT SELECTION

The legislation initially authorizing JPA loans provided that aid would be available to "energy-impacted" areas. Four years ago, it was decided that the entire state qualifies under this definition, so all areas are now eligible to receive loans. Almost all applicants receive loans, so targeting and distribution criteria are not a subject of much debate. The

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64 Conversation with Mike Hackett, Wyoming Department of Environmental Quality, Cheyenne, WY, November 30, 1988.

65 Conversation with Sharon Garland and Don Collamore, Assistant Commissioners, Department of Public Lands & Farm Loans, Cheyenne, WY, November 30, 1988.

program's operative principle is simplicity; the Governor feels that the localities are entitled to the loans and few barriers should be placed in the way of their getting funds.[66]

JPA loans outstanding have increased in recent years, possibly reflecting the fiscal pressures imposed on localities by declining population, employment, and tax bases. In 1983, for example, the program had used just over half its statutory lending capacity, with $57.4 million in loans outstanding (Table 5). By the end of 1988, however, this total had risen to $75.4 million.

## BALANCED POWERS: THE LEGISLATURE'S ROLE

In Wyoming, government is accessible and accountable to the people as individuals. The Governor and other state officials travel around the state holding "Capitol for a Day" sessions in different communities, allowing all citizens access to their government and its decision-making process. Legislative oversight over executive branch actions is less important -- and less stringent -- in a state where an individual farmer seeking a loan can expect to discuss it directly with the Governor, as is common with Farm Board Loans.[67]

The JPA program has always had enough funds to aid all eligible applicants, but this could change. The increased

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66 Conversation with Assistant Commissioner Don Collamore, November 30, 1988, Cheyenne, Wy.

67 Conversation with Richard Miller, Director, Legislative Service Office, November 30, 1988, Cheyenne, WY.

Table 5.

The Wyoming Joint Powers Act Loans:
Activity Levels and Loans Outstanding
(in millions of dollars)

| Year | New Loans |
|---|---|
| 1974 | $ 6.3 |
| 1975 | 10.2 |
| 1976 | 10.9 |
| 1977 | 5.4 |
| 1978 | 1.2 |
| 1979 | 2.3 |
| 1980 | 10.8 |
| 1981 | 20.0 |
| 1982 | 13.0 |
| 1983 | 5.2 |
| 1984 | 8.5 |
| 1985 | 5.4 |
| 1986 | 6.3 |
| 1987 | 9.4 |
| 1988 | 9.3 |
| **Outstanding Loans, Selected Years** | |
| 1983 | $ 57.4 |
| 1984 | 60.0 |
| 1986 | 63.5 |
| 1987 | 56.3 |
| 1988 | 75.4 a/ |

Sources: Author's compilation of data in Wyoming Department of Public Lands and Farm Loans, "Joint Powers Act Report, As of October 31, 1988," unpublished; and State of Wyoming, Annual Report of the Department of Public Lands & Farm Loans, Table X, various years.

a/ Includes loans approved but not yet closed.

utilization of JPA loans suggests that local need for aid is increasing. If outstanding loans start to reach the program's statutory capacity, state officials may face some choices about where development resources are to be invested, and the legislature is likely to become active in these decisions.

All available state resources are likely to come under increasing pressure, which could further increase the legislature's role in project selection. The state's economic decline left it with some excess public works capacity. Some such facilities are being retired early, while others are being decommissioned. In other cases, however, facilities are being subsidized with general-funds subsidies or operated at uneconomic utilization levels.[68] This will drain resources that would have been available for other needs.

The state's social problems are also becoming increasingly urgent. Much of the state's population arrived during its economic boom. The economic decline left many of them without jobs or the community roots that could cushion the hard times. These problems are challenging the state's philosophy of self-reliance and minimal government, and could force choices between economic development spending and social programs.

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[68] Conversation with Richard Moore, former Director of Wyoming Industrial Siting Administration, November 30, 1988, Cheyenne, WY.

## MEASURES OF PROGRAM PERFORMANCE

Some measures of program performance used in this report cannot be applied to the Wyoming program. It is difficult to assess a program's performance in meeting the needs of distressed or rural areas when all its jurisdictions are distressed by definition and nearly all are rural. Broad eligibility and liberal funding relative to needs have meant that the allocation of aid was governed largely by local initiative and not by state-imposed standards of targeting or credit-worthiness.

In 1986, the last year for which comprehensive data are available, Wyoming spent about $90.4 million on public works facilities.[69] JPA loans accounted for about 7 percent of that total in that year. Program officials indicated that the program is the only available source of significant unrestricted funding for public works; much state public works spending is project-specific or not available on as generous terms as the JPA loans. In particular, the state will be unable to establish a state revolving loan fund under the Water Quality Act because it does not have any projects identified as eligible for federal aid, and most JPA projects would not meet the federal criteria. The JPA program is thus likely to become increasingly important as the state works to maintain and expand its public works investment.

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[69] Author's calculations based on The Council of State Governments, op. cit., Appendix C, "State Assistance to Local Governments for Public Works, Program Inventory."

## STATE AID FOR LOCAL PUBLIC WORKS IN MASSACHUSETTS

Massachusetts is one of the nation's oldest states, and one of its most affluent. Its average per capita income of $19,142 in 1987 was nearly 24 percent higher than the national average, and increased by more than 80 percent during the 1980s. More than 90 percent of its residents live in areas considered urban according to Census definitions. The state is densely populated, with more than 745 persons per square mile, over 10 times the national average. While the state's income has been growing, its population has increased less than 1 percent during the 1970s and less than 2 percent between 1980 and 1986.

The state's age and population density led to public works problems. More than 47 percent of the housing standing in 1980 was built before 1940, compared with a national average of just over 26 percent. With older communities comes older, decaying infrastructure. In the early 1980s, state agencies estimated that 20 percent of the state's bridges needed immediate repair or replacement, and, as of December, 1984, contamination had forced 54 communities to close water supplies.[70]

Massachusetts public works investment was low relative to these needs and unstable. Infrastructure investment in 1983 was at its lowest inflation-adjusted level in 20 years, and varied by

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70 Office of the Governor, MassBank: A Proposal to Rebuild and Expand the Commonwealth's Infrastructure, undated, pp. 5-6.

as much as 30 percent from year to year.[71] A Harvard-MIT study conducted in conjunction with the Joint Economic Committee of the U.S. Congress concluded that state infrastructure spending needed to double to meet current and emerging needs.

The state's fiscal response to these problems was shaped by several factors.

Declining debt capacity. Massachusetts ranked only twenty-third in the nation in total state and local debt per capita in 1982, and its per capita debt was 83.5 percent as large as the national average.[72] It ranked ninth in general obligation debt, however, and its per capita debt in this category was 26.5 percent higher than the national average. The state's high reliance on general obligation debt was believed to be increasing its borrowing costs despite the state's strong economy, while its capacity for revenue-backed debt was largely untapped.

Declining revenue burdens. Between 1977 and 1984, the state's revenues (state and local taxes and fees) had declined from $176 per $1000 in personal income, or nearly 10 percent more than the national average, to about $147 per $1000 in personal income, or nearly 9 percent less than the national average.[73] Some increase in taxes was thus judged to be a viable way to increase infrastructure investment.

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71 Office of the Governor, pp. 6-7.

72 Office of the Governor, p. 17.

73 Office of the Governor, Figure 4.

State-local fiscal balance. The Massachusetts state government accounts for a 71 percent of combined own-source state and local spending, a larger share than all but three states, and well above the national average of 57 percent.[74] One reason for the relative fiscal importance of the state government is the fact that Massachusetts county government has never been strong.

This share has increased significantly in recent years. In 1975, the state accounted for 57 percent of combined general expenditure, close to the national average of 55 percent.[75] The high and increasing importance of the state's fiscal role meant that solutions to the state's infrastructure problem would rely on state, rather than local, resources.

The state's fiscal role has increased in response to the passage of Proposition 2 1/2 in 1980, a voter referendum that limited local property tax revenues and spending. Cities and towns with a tax rate below the lesser of their 1979 rate or 2 1/2 percent of full and fair real estate market value could raise their rates 2 1/2 percent per year until the 2 1/2 percent ceiling was reached. Communities with tax rates exceeding the ceiling had to reduce their tax rates 15 percent annually until they reached the limit. Growth in municipal spending is also limited to 2 1/2 percent per year, even if property values grow more rapidly than 2 1/2 percent per year.

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74 ACIR, Table 50. The remaining three states -- Hawaii, Alaska, and New Mexico -- account for 76 to 78 percent of state and local spending.

75 ACIR, Table 49.

The state has undertaken to compensate local governments for much, if not all, of revenue foregone as a consequence of Proposition 2 1/2. Between 1981, the first year under the limits, and 1988, local property tax revenues increased by just over 1.8 percent per year, or 13.5 percent over the seven-year period.[76] State aid to local governments increased by 12.3 percent per year over this period, more than doubling in total. Increased state aid accounted for 56 percent of the increase in the state's budget between 1981 and 1988.

The state also compensates local governments for 50 percent of the funds lost as a result of the elimination of the federal General Revenue Sharing program. These funds are received as part of the state's Resolution Aid program, an unrestricted grant program that accounts for about three-quarters of state aid to local governments.

## THE MASSBANK PROPOSAL

The Massachusetts Development Bank (MassBank) was proposed by Governor Michael Dukakis in early 1984. It was to be an independent revenue bonding authority located in, but not supervised by, the Executive Office of Administration and Finance. MassBank was designed to reduce the state's reliance on general-obligation debt, tap its economic growth for infrastructure finance, and enhance local fiscal capacity and

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76 Author's calculations based on unpublished data provided by the Massachusetts Department of Administration and Finance.

credit-worthiness in the face of revenue and spending limitations.

**Financial Structure**

The MassBank financing structure was to have four major elements:

- Corporate taxes were to be reduced from 9.5 percent to 8.5 percent of net income and from $2.60 to $2.28 per $1000 of assessed property value.

- The corporate tax reductions would be replaced by an infrastructure development assessment (IDA) set at 1 percent of new income taxable in the state. The IDA would be dedicated to MassBank to support revenue bonds. Total IDA receipts would be capped at $100 million.

- Massachusetts corporations would be allowed to take only 60 percent of federal accelerated depreciation deductions (enacted in 1981 and repealed in 1986) in the first year, deferring the unused depreciation deduction for four years. This limitation was intended to compensate the state budget for the IDA outflow to MassBank.

- To further increase state revenues, the state would adopt the water's edge unitary method of calculating state corporate tax liability. This was intended to reduce the ability of corporations doing business in the state to escape state tax by establishing out-of-state subsidiaries.

MassBank was intended to increase both state and local capacity to finance infrastructure projects. For the state, it would facilitate the issue of revenue bonds. The IDA revenues would be used to secure revenue bonds for state infrastructure projects undertaken by state development agencies. The projected revenues were expected to be able to support up to $1 billion in new borrowing over the following three years.

The MassBank legislation was to enhance local borrowing capacity in several ways. Following the passage of Proposition 2 1/2, 26 cities and 11 towns had been suspended from the bond market.[77] The legislation would allow all communities to issue revenue bonds for local revenue-producing infrastructure projects. Localities would also be authorized to set up special assessment districts so that revenues from local infrastructure projects could be dedicated to support these projects. Localities would also be allowed to pledge a portion of local aid as payment of any debt obligation. Finally, MassBank itself would provide a bond bank, purchasing the debt obligations of localities that were without market access despite these enhancements. MassBank did not provide a revolving loan fund.

**Organization**

MassBank was to be an independent executive branch authority. It was to be managed by a five-member board of directors, including the state treasurer and secretary of administration and finance ex officio, and three additional members appointed by the Governor. According to an opinion of the state's Supreme Judicial Court, the Bank's independence was necessary to insulate the Bank's revenues from the state's annual appropriations process and provide a stable source of infrastructure finance.[78]

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77 Office of the Governor, p. 15.

78 Executive Office of Administration and Finance, "Answers to Questions About MassBank," March 25, 1985 (duplicated), p. 25.

**Project Selection**

MassBank was to supply funds only for revenue-generating projects: state highways, bridges and tunnels, sewerage systems, and water supply systems. The role of state development agencies in planning, selecting, designing, and constructing projects was to remain unchanged, and the legislature was to exercise the same approval and oversight of projects as under prior law.

**THE DEBATE**

The MassBank proposal was subject to several liabilities. One was its complexity. After a court decision eliminated the unitary tax change as a financing mechanism, the proposal was never successfully reassembled. It also seemed to undermine the legislature's authority, although the nature of the perceived threat is not clear and the proposal's executive branch proponents argue that it would not have infringed on the legislature's prerogatives.

Perhaps most importantly, however, the proposal confronted the legislature with difficult decisions in an environment that did not seem to call for hard choices. The state was growing vigorously; personal income of Massachusetts residents increased by more than 56 percent between 1980 and 1985, compared with 47.3 percent for the nation as a whole. Thus, its general revenues grew 13.4 percent between 1984 and 1985 and 17.6 percent between 1985 and 1986 (Table 6). This growth far exceeded that experienced by all other states. New taxes thus did not seem to

Table 6.

Revenue Growth and Capital Spending
in Massachusetts, Selected Years

| Year | State General Revenue a/ (in billions of dollars) | Percent Change Massachusetts | Percent Change All States |
|---|---|---|---|
| 1984 | $7.3 | -- | -- |
| 1985 | 8.3 | 13.4 | 10.3 |
| 1986 | 9.7 | 17.6 | 7.0 |

| | Capital Spending b/ (in millions of dollars) |
|---|---|
| 1983 | $464.0 |
| 1984 | 395.4 |
| 1985 | 450.8 |
| 1986 | 493.8 |
| 1987 | 596.9 |
| 1988 | 690.0 |
| 1989 | 925.0 c/ |

Sources: Revenue data calculated by author based on ACIR, Significant Features of Fiscal Federalism, 1985-86, 1987, and 1988 editions (Washington, D.C.: ACIR, various years). Capital spending data provided by Ron Lanoue, Manager for Capital Spending, Massachusetts State Budget Bureau.

a/ General revenues for Massachusetts and for all states calculated to exclude federal aid.

b/ Debt-financed only.

c/ Projected for the coming fiscal year.

be needed. MassBank's cumulative revenue requirements of $100 million were also seen as small compared with the $1 billion increase in revenues between 1984 and 1985 and the $1.4 billion increase between 1985 and 1986.

The perceived urgency of enacting MassBank was also blunted by the fact that the state had eliminated staffing bottlenecks slowing the growth of capital spending. In 1984, even as MassBank was being debated, the dollar volume of state construction projects awarded reached $183 million, a 55 percent increase in two years.[79] The state thus seemed to be able to grow its way out of its public works deficiencies.

## PUBLIC WORKS SPENDING IN MASSACHUSETTS

Some of MassBank's goals were accomplished in its absence; others were not. Capital spending is growing rapidly. The doubling of spending judged necessary by MassBank's framers has been accomplished. Projected state capital spending in state fiscal year 1989 will exceed the 1984 level by nearly 134 percent (Table 6).

The state's general obligation debt capacity remains heavily burdened, however, leading to lower credit ratings (AA and AA+) than might otherwise be warranted. With a backlog of authorized but unissued debt, the state Budget Bureau established a Manager for State Capital Spending last year to manage spending and make

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[79] Data provided by the Executive Office of Administration and Finance.

sure that bonds are not issued at a faster rate than markets will accept. The revenue bond question could thus emerge again.

The state remains committed to a high and stable level of local government support. Executive branch officials state that its recent widely-publicized budget problems will not force a reduction in local aid; rather, only the rate of increase might decline.

Emerging public works problems could change the character of state aid, however. For example, the solid waste disposal problem might be addressed with a combination of grants and loans. Local option taxes may be enacted, and the legislature may exercise its right to amend Proposition 2 1/2 to reduce its fiscal burden on the state.